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LAW and ACCOUNTING

1987 Supplement

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PART A (iii)

INTRODUCTION TO FINANCIAL STATEMENTS

The Balance Sheet — A More Detailed Examination

Exhibits 2-3 through 2-6 illustrate the financial statements of the Mercury Truck Manufacturing Corporation for the year ended December 31, 19x3. The balance sheet in Exhibit 2-3 is divided not only into the major categories of assets, liabilities, and owners' (shareholders') equity but several subcategories or accounts as well.

EXHIBIT 2-3

Mercury Truck Manufacturing Corporation
Balance Sheet
December 31, 19x3

Assets

Current assets		
Cash		$ 1,042,954
Marketable securities		380,000
Accounts receivable	$9,083,414	
Less allowance for doubtful accounts	100,000	8,983,414
Inventories		10,958,103
Prepaid expenses		331,115
Total current assets		21,695,586
Noncurrent assets		
Property, plant, and equipment		
Land		918,649
Buildings	4,805,401	
Less accumulated depreciation	1,207,021	3,598,380
Machinery and equipment	9,835,027	
Less accumulated depreciation	2,414,042	7,420,985
Net property, plant, and equipment		11,938,014
Investment and other assets		
Investment in subsidiary		6,211,284
Notes receivable		3,682,487
Unamortized organization costs		1,000

EXHIBIT 2-3 (continued)

Mercury Truck Manufacturing Corporation
Balance Sheet
December 31, 19x3 (continued)

Assets

Patents and trademarks	34,000
Interest on long-term debt paid in advance	33,111
Total investment and other assets	9,961,882
Total noncurrent assets	21,899,896
Total assets	$43,595,482

Liabilities and Shareholders' Equity

Current liabilities	
Accounts payable	$ 5,515,469
Notes payable	4,152,249
Salaries and wages payable	1,938,795
Taxes payable	1,662,171
Interest payable	82,157
Total current liabilities	13,350,841
Noncurrent liabilities	
Advances from customers	87,218
Notes payable	3,057,679
Bonds payable	10,048,075
Total noncurrent liabilities	13,192,972
Total liabilities	26,543,813
Shareholders' equity	
Preferred shares, 10% dividend	96,655
Common shares (no par value, 625,773 shares issued and outstanding)	625,773
Retained earnings	16,329,241
Total shareholders' equity	17,051,669
Total liabilities and shareholders' equity	$43,595,482

Current assets

Current assets include cash and such other assets that will either be transformed into cash or will be sold or consumed within one year or within the *normal operating cycle* of the business if longer than one year. For most businesses the normal operating cycle is one year or less, but for some (such as those in the tobacco or distilling industries where the products must be stored for a period of several years) it may be a longer period.

Cash includes not only currency but savings bank or commercial bank deposits (after deducting outstanding cheques) as well. When it is said that

a company disburses "cash" there is no necessary implication that it is making a payment in currency. The term could readily (and most commonly does) apply to payments by cheque.

Marketable securities include shares of ownership in other companies and other securities held by the firm for a short period of time (usually less than one year). In Canada such securities are ordinarily reported at original cost, with market values being shown in brackets:

Marketable securities, at cost (market value $384,500)	$380,000

If the market value were much less than $380,000 (say $305,000) the carrying value ($380,000 in Exhibit 2-3) would be reduced to $305,000 and the $75,000 difference would be included on the income statement as an expense. When market values exceed cost, Canadian accountants do not increase the carrying value on the balance sheet. This is primarily because of the accountant's tendency to be conservative in asset valuation and revenue recognition. (The concept of conservatism is discussed in later chapters. In view of differing accounting objectives and interpretations of facts, what is conservative to one person or in one situation, may not be conservative to another person or in another situation.)

There are already some situations in Canada where the objectives of accounting are such that it makes sense to record marketable securities at market value. Open-ended mutual funds (companies whose assets are almost exclusively comprised of the shares of other companies, and who are continually buying and selling common shares in themselves from and to individual investors) sell their shares to the general public on the basis of the market value per share of the mutual fund's net assets. Since such shareholders are interested in market values — not original cost — it is wise to report to them on this basis.

Accounts receivable — the amounts due from customers — represent those amounts that can be expected to be collected within the operating cycle (those that cannot are included among noncurrent assets). Deducted from accounts receivable is an "*allowance for doubtful accounts*" — an estimate of the amounts owed to the company that will be uncollectible. Thus, the net amount of accounts receivable represents not the total amount owed to the firm but only the amount that it estimates will actually be collectible.

Inventories include both items available for sale to customers and raw materials, parts, and supplies to be used in production. Inventories are ordinarily reported at original cost of either purchase or production, but in the event that the cost of replacing such items has declined, then the inventories may be "written down" to reflect the decline in value. As with marketable securities, increases in value are not ordinarily given similar accounting recognition.

Prepaid expenses represent services or rights to services purchased but not yet consumed. As they are consumed they will be "charged off" as actual expenses. A firm might, for example, purchase a one-year insurance policy for $120 ($10 per month). At the time of purchase it would probably record the policy as a current asset, prepaid insurance — $120. Each month it would reduce the asset by one twelfth of the original amount ($10) and would charge insurance expense with the same amount. Thus, after eight months, the balance in the prepaid insurance account would be only $40 (four months remaining times $10 per month). Other common prepaid expense accounts are prepaid interest, prepaid advertising, and prepaid rent. Prepaid expenses are one type of *deferred charge* — outlays made in one period to benefit future periods.

Noncurrent assets

Noncurrent assets are those assets that cannot be expected to be sold or consumed within one year or within a normal operating cycle of the business if longer than one year. Noncurrent assets are usually considered to be *long-lived* assets, and plant assets in particular are often referred to as *fixed* assets.

Property, plant, and equipment are recorded on the balance sheet at original cost. Deducted from each of the assets other than land, is accumulated depreciation — an allowance to reflect the fact that the assets are being "consumed" over time, by wear and tear as well as by technological obsolescence. Depreciation on each individual asset or group of similar assets is computed separately, and the total amount accumulated is a function of the age and expected useful life of the asset. No depreciation is provided for land since it is not consumed over time and seldom declines in utility.

The classification *investments and other assets* includes amounts that are not used up for at least either one year or one operating cycle if greater than one year, and amounts that the company has invested in other companies. If, for example, a company owns 30 percent of another company, such interest would ordinarily be included among investments and other assets. An interest in another company, however, may be classified as "marketable securities," a current asset, or as "investments in subsidiaries," a noncurrent asset. The decision as to how the interest should be classified depends to a large extent on the *intent* of the company's management. If it intends to maintain its interest for a relatively long period of time and views ownership as a long-term investment, then the amounts owned should be classified as a noncurrent asset. If, on the other hand, the company purchases the interest with the intention of selling it as soon as additional cash might be needed (for example, if it purchases a few hundred common shares of Canadian Pacific as a temporary investment with no intention of buying more and trying to exercise significant control or

influence over the company), then the amount owned would be classified as marketable securities, a current asset.

Noncurrent assets may occasionally include *deferred charges* such as prepaid expenses as well. If, for example, a company purchased an insurance policy or a license that had more than a one-year life, then the percentage of original cost representing the unexpired portion of such insurance policy or license might be included among noncurrent assets.

Some deferred charges represent outlays that will benefit future accounting periods but for which both the number of such periods and the value of the benefits are exceedingly difficult to measure. Consider the costs incurred to organize a corporation: the legal fees required to draw up the documents of incorporation, the costs of printing the shares to be issued, and the fees paid to the government upon filing for a corporate charter. Such costs — like those of buildings and equipment — were incurred to benefit the business over a long period of time. Just as income of a single year of operations would be understated if the entire cost of a building were charged as an expense at the time it was purchased, income would also be distorted if the costs of organizing the corporation were charged as an expense in the first or second year after incorporation. As a result, in practice, organizational costs may be reported as an asset for a few years until the company grows to a size that the organization costs may be expensed because, on a relative basis, they are trivial.

Other common examples of deferred charges are interest paid in advance (often in connection with bonds payable issues) and amounts paid to acquire new businesses in excess of the value of the specific assets acquired (i.e., goodwill).

Deferred charges representing benefits which will accrue to the firm over a long period of time in the future are often a source of confusion to shareholders. Deferred charges, unlike most other assets, are intangible and frequently have no market value. Amounts spent as organizational costs, for example, cannot readily be transferred to any other business entity; they cannot be sold to outsiders. How, then, can such amounts be considered assets?

The question must be answered in terms of the nature of all assets. Assets can be defined as future services to be received in money or benefits convertible into money. They can readily be viewed as "bundles of services" available for use or sale by a particular entity. The determination of service potential is made with respect to the business entity issuing the financial reports — not with respect to the world at large.

In accordance with currently employed practices of valuation (alternative practices will be discussed in subsequent chapters), assets are measured and recorded at the time they are acquired at the price paid for them. As their service potential declines over time (e.g., as the assets are consumed) the reported value is reduced *proportionately* through the process

of depreciation or amortization. If one third of the services has been consumed, then the asset is reported at two thirds its original cost. As long as the asset is not intended for sale to outsiders, market value seldom enters into the determination of the amount at which an asset is reported. Indeed, an automobile owned by a business might be reported at an amount either greater or less than the price at which similar used cars are being traded.

The outlay for organizational costs will benefit many accounting periods. To the extent that it has "future service potential" (the corporation would not exist without it) it can properly be considered an asset.

Current liabilities

Liabilities are also categorized as either current or noncurrent. *Current liabilities* are those expected to be satisfied out of current assets (or through the creation of other current liabilities) or to be satisfied within a relatively short period of time, usually one year or one operating cycle of the business if greater than one year. Most common categories of current liabilities are amounts owed to employees for wages and salaries; to suppliers for services, supplies, and raw materials purchased (conventionally called trade accounts, or simply accounts payable); to the government for taxes (taxes payable); and to banks or other lenders for amounts borrowed (notes payable) and for interest on such amounts (interest payable) that is payable within one year or one business cycle if greater than one year.

Noncurrent liabilities

Noncurrent liabilities include all other amounts owed. They include long-term (for a period greater than one year) notes as well as bonds payable. Bonds are similar to long-term notes but differ in that the promise to pay is usually included in a more formal legal instrument and in that the term of the loan is often longer. The same bond or note may be classified as both a current and a noncurrent liability. The portion that is due within one year would be considered current; the portion due beyond one year would be noncurrent.

Just as amounts that a company pays in advance to receive goods or services in the future are considered assets of the company, so too the amounts that others pay to the company for goods and services to be provided by the company are considered liabilities of the company. Supose that Air Canada sells a ticket for a trip which the traveler intends to take a month after his purchase. At the time of sale the airline receives an asset (cash or accounts receivable) equal to the price of the ticket. At the time of sale it incurs an obligation to provide services (i.e., one airline trip) to the customer. To be sure, the obligation is not a liability in the usual sense in that the airline has no monetary debt outstanding to the customer. But it is an

obligation nonetheless. Such amounts are reported among the liabilities and may be labeled as appropriate: "advances from customers," "revenues received but not yet earned," or, less descriptively but more generally, "deferred credits." They are classified as current if the obligation is likely to be satisfied within one year; otherwise they are classified as noncurrent.

"Nonassets and nonliabilities"

Not all amounts that a firm will have to pay to others if it continues in business are recorded as liabilities, nor are all amounts that it can be expected to receive recorded as assets. If a firm signs a three-year contract with a new president, for example, and promises to pay him $100,000 per year, the firm may be legally liable for the full $300,000 as long as the new president is willing to provide the required services. The firm would not, however, record the full amount as a liability. Only as the president "earns" his salary — i.e., as he performs his side of the bargain — would the firm record as a liability amounts earned but not paid. This is also the case if a firm borrows $1,000 from a bank at a 12 percent rate of interest and gives the bank a one-year note. At the end of the one-year period, the firm will owe the bank $1,120 — the principal of $1,000 plus interest of $120. At the time the note is signed, however, the only liability that would be recorded is the $1,000 actually borrowed. Each month, as the company has use of the borrowed funds, an additional $10 interest for one month will be recorded as a liability. The bank, for its part, would record as an asset a note for $1,000. It, too, would recognize an asset, "interest receivable," only as it earns the interest revenue with the passage of time.

In general, assets and liabilities arising out of "*executory*" *contracts* (those contingent upon the mutual performance of the two sides to the contract) are recorded only to the extent that one of the parties has fulfilled its contractual obligations. The reason for such limited accounting recognition of assets and liabilities will become considerably clearer as the relationship between balance sheet and income statement accounts is discussed more fully in subsequent chapters.

Owners' equity

The shareholders' equity section of the corporate balance sheet is divided into at least two main subsections. The first indicates the capital contributed by shareholders — either at the time the corporation was formed or when additional shares were issued in the course of the corporation's existence. Corporations may issue several different types of shares. *Common shares* generally give their owners the right to vote for members of the corporation's board of directors as well as on numerous other corporate matters and the right to share in corporate profits whenever dividends are declared by the board of directors. *Preferred shares*, on the other hand, generally do *not* carry voting rights, but do ordinarily guarantee the owner that he will receive dividends of at least a minimum amount each year. The dividend rate is fixed at the time the share is issued. Some provincial Corporations or Companies Acts in Canada allow a company to assign a par value (e.g., $10 per share) to their common and any preferred shares. Such values have legal, but little economic, significance, and shares are commonly issued for amounts above (and sometimes below) these arbitrary par values. Amounts which the company receives in excess of par value are included on the balance sheet as "contributed surplus" — and shown as part of shareholders' equity.

The second subsection, retained earnings, indicates the accumulated earnings of the business. Retained earnings will be commented on in greater detail later in this chapter.

If the firm is not a corporation, that is, if it is a *sole proprietorship* (a firm owned by a single individual) or a *partnership* (a firm owned by two or more parties), then the owners' equity section of the balance sheet may take a somewhat different form. Since such enterprises do not issue shares and are not bound by many of the legal restrictions that apply to firms which do, it is generally most useful to readers of the financial reports to indicate the entire closing equity balance of each owner on a separate line. If Mercury Truck Manufacturing Corporation were owned by two partners, John Switzer and William King, the shareholders' equity section of the balance sheet would appear as:

Partners' capital:	
John Switzer, capital	$ 9,525,347
William King, capital	7,526,322
	$17,051,669

The term "corporation" would not be part of the title of the firm if it were a partnership.

The Income Statement — A Closer Look

Statements of income are presented in a variety of formats, but virtually all are based on the fundamental relationship

Revenues − Expenses = Net Income.

Although the income statement illustrated in Exhibit 2-4 is that of a manufacturing concern, there are no costs of either labor or raw materials listed

among the expenses. The company would, of course, maintain separate accounts for labor, materials and other factors of production, but to avoid inundating the reader with detail such costs are grouped together in one account, *cost of goods sold*. Cost of goods sold may not represent the actual costs of labor, material, and other factors of production incurred during the reporting period. Adjustment must be made for those costs applicable to goods that may have been produced but not yet sold (i.e., retained in inventory) and those goods that have been sold but were produced in prior periods.

EXHIBIT 2-4

Mercury Truck Manufacturing Corporation
Income Statement
Year Ended December 31, 19x3

Revenues	
Sales	$32,904,468
Rents received from leased equipment	3,464,491
Miscellaneous revenue	1,209,975
	37,578,934
Expenses	
Cost of goods sold	28,691,473
Selling and administrative expenses	2,319,231
Depreciation expense	1,704,621
Property and other taxes*	823,347
Interest expense	1,221,896
	34,760,568
Income before income taxes and extraordinary items	2,818,366
Taxes on income	1,245,000
	1,573,366
Extraordinary gain received upon settlement of legal action, less applicable income taxes of $276,923	300,000
Net income	$ 1,873,366

*This line excludes taxes on income, which are shown below.

Occasionally firms engage in transactions or are affected by events that are highly unusual and are unlikely to be repeated. Examples of such events might be losses from natural disasters or from government expropriation of a company's plant in another country. Unless such gains or losses are segregated from income derived from the normal operations of the firm, the income statement will not serve as a meaningful instrument of comparison among financial performances of various years. Moreover, the income of the year in which such events or transactions occurred will provide little insight into earnings potential for the future. As a consequence, such *extraordinary items* — those which are exceptional in nature and infrequent in occurrence — are reported separately in the income statement. And since these events are likely to have a major impact on the income taxes of the firm, the applicable taxes are also reported separately.

The Statement of Retained Earnings

The statement of retained earnings (Exhibit 2-5) serves as the link between the income statement and the balance sheet. The basic accounting equation for incorporated companies can readily be expanded as follows:

Assets − Liabilities = Capital contributed by owners + Retained earnings.

Retained earnings represent the sum of the earnings of each accounting period that the company has been in existence less the amounts paid as dividends to shareholders. The retained earnings per the balance sheet at the beginning of the period (which of course must be identical to that at the end of the previous period), plus the income for that period per the income statement, less any dividends declared during the period, equals the retained earnings at the end of the period:

Retained earnings, balance at beginning of year + Income − Dividends declared = Retained earnings balance at end of year.

The statement of retained earnings, by indicating both dividends declared during the year and the income for the year, provides a reconciliation of the retained earnings at the beginning of the year with that at the end.

EXHIBIT 2-5

Mercury Truck Manufacturing Corporation
Retained Earnings Statement
Year Ended December 31, 19x3

Balance, January 1, 19x3	$15,210,861
Net income for the year	1,873,366
	17,084,227
Less dividends	754,986
Balance, December 31, 19x3	$16,329,241

Retained earnings, it cannot be overemphasized, *is not cash* or some other asset or resource of the firm. It is a residual figure in the double entry system, representing a portion of owners' equity. In a similar vein, earnings *per se* cannot be distributed to shareholders; earnings cannot be used to purchase goods or services. Only cash or other assets are generally accepted in exchange for other goods or services. Retained earnings represent nothing more than a *claim* against the assets of the enterprise — the claims of the owners attributable to the income earned by the firm over the course of one or more years. Although assets must be equal to the claims against those assets (claims of owners as well as creditors), *there is generally no specific relationship between particular assets and particular claims*.

Dividends are distributions of the assets of the incorporated enterprise to its owners. The asset distributed most often is cash, but it could, in fact, be any asset of the firm. As the assets of the firm are reduced upon distribution to the owners, so also are the claims of the owners against such assets. Assume, for example, that several individuals contribute $1,000 to form a corporation. During the first year of operations the firm earns $200. Its position, at the end of the first year, as indicated by the accounting equation might appear as follows:

Assets	=	Liabilities	+	Capital contributed by owners	+	Retained earnings
$1,200	=	$0	+	$1,000	+	$200

If the firm declared and paid a dividend of $100, then the position of the company after the $100 in assets had been distributed would appear as

$1,100	=	$0	+	$1,000	+	$100

The statement of retained earnings is not included in the financial reports of all corporations. A few companies indicate the dividends distributed to shareholders directly beneath the net income figure on the income statement and omit the reconciliation between beginning-of-year and end-of-year retained earnings.

The Statement of Changes in Financial Position

The statement of changes in financial position (SCFP) has been in existence for over 100 years but has gained prominence only in the last 10 years. Large companies that sell shares to the public are required to include the SCFP in their financial reports filed with Provincial Securities Commissions. However, in some other situations the SCFP may not be required in order for the financial statement package to be in accordance with contemporary reporting "principles." Chapter 14 discusses this aspect of the topic

in more detail. The SCFP is gaining greater acceptance year after year; and no doubt will be a required statement under GAAP in a few years.

The SCFP has a flexible design because its purpose is to focus either: (1) on changes in liquidity (such as cash), or (2) on important transactions which are not disclosed, or disclosed well, by a balance sheet and income statement. The SCFP may therefore be in balanced form, like a balance sheet, or highlight a change in one or more accounts by using the income statement design, which stresses the "bottom line." In some situations it may be possible to highlight both liquidity changes and important transactions during a period, but often it is not possible to accomplish both with one financial statement design. We therefore have to apply our judgment.

Exhibit 2-7 contains the financial statements of John Labatt Limited, a large Canadian company. Their SCFP (page 55) focuses on *working capital* (which is another name for current assets minus current liabilities). In some companies a change in liquidity is measured best by viewing movements in the *cash* position. In other companies, cash, accounts receivable, inventory and accounts payable may change so quickly that they should be part of liquid funds. Liquidity is a somewhat elusive concept which broadly describes the net resources which the company can call upon to pay for expected and unexpected expenditures. A bank, for example, may measure its liquidity in terms of cash on hand plus cash which it will receive shortly. A grocery store may include inventory in its definition of liquidity because it could sell off some of its inventory at reduced prices if it had unexpected cash needs. John Labatt Limited may have chosen working capital as its liquidity measure, or it may feel that the working capital design helps to focus on important transactions. Another possibility is that working capital may be a reasonable compromise between liquidity and important transactions during its year ended April 30, 1978.

In contrast to Exhibit 2-7, Exhibit 2-6 uses a balanced format of SCFP to portray important transactions and results for Mercury Truck Manufacturing Corporation. By employing the balanced format there is no "bottom line" of liquidity changes, and attention is thereby shifted to several larger amounts in the statement. Sometimes, a "bottom line" format is used to focus on major nonliquid transactions (for instance, major expenditures on fixed assets by a public utility company). However, Mercury Truck did not have any major transactions which dwarfed other activities during the year. Hence, the balanced format seems appropriate for this year's events.

Whereas Exhibit 2-7's SCFP is fairly traditional, Exhibit 2-6's is more consistent with recent Canadian pronouncements which advocate flexible formats, grouping similar items (for example, dividends to shareholders are subtracted from income, and proceeds on sale of equipment are shown with additions), and a greater stress on disclosing important financing and investing activities. Roughly speaking, financing activities are those which affect the liability and equity side of the balance sheet. Investing activities

are primarily concerned with the asset side of the balance sheet. Inventory is separately reported (instead of being part of working capital) because it is a major item, and presumably because some users of the financial statements want to know about such changes and are entitled (by law or for other reasons) to this information.

EXHIBIT 2-6

Mercury Truck Manufacturing Corporation
Statement of Changes in Financial Position
Year ended December 31, 19x3

Financing activities:	
From regular operations:	
Net income before extraordinary gain	$ 1,573,366
Add operating items not affecting funds	1,704,621
	3,277,987
Less dividends	754,986
	2,823,001
Settlement of lawsuit	300,000
Issue of common shares	4,960,519
Issue of long-term debt	1,000,000
	$ 8,783,520
Investing activities:	
Additions to property, plant and equipment	$ 3,511,819
Less proceeds of disposals of equipment	500,000
	3,011,819
Addition to inventory $6,000,000 less $2,900,000 goods sold	3,100,000
Investments and other assets acquired	254,735
Reduction of long-term debt	2,207,656
Increase in working capital, excluding inventory	209,310
	$ 8,783,520

Further discussion of the SCFP is deferred until Chapter 14. However, it is important to bear in mind that Canadian practice seems to be lagging behind professional pronouncements which are advocating more effective use of the SCFP. The formats of Exhibits 2-6 and 2-7, and the essence of their differences, may be difficult to comprehend at this point in the book. It is probably wise to refer to them from time to time as Chapters 3 to 13 are completed; otherwise, Chapter 14 may prove difficult. Our basic theme is that the design and content of the SCFP is dependent on the objectives or purposes of financial accounting and reporting, the facts (types of transactions encountered during the period), and any legal restrictions or constraints.

A Financial Report Illustrated

John Labatt Limited's financial statements for their 1978 year have been reproduced in their entirety in Exhibit 2-7. Financial statements are provided annually to shareholders and other interested parties. The company also issues quarterly statements in an abbreviated form to shareholders and others.

Over three quarters of the company's "income" (normally called revenue) comes from sales of beer in several countries but Labatt's has diversified and is continuing to do so into a variety of consumer and non-consumer products. The following companies, among others, are fully or partly owned by Labatt's: the Toronto Blue Jays (of the American Baseball League); Laura Secord; Casabello Wines Ltd; McGavin Foods Limited; Chateau Gai Wines; Catelli Foods; and Ogilvie Flour Mills. The financial statements are described as being *consolidated* because the assets, liabilities, sales and expenses of *all* companies in which Labatt's has over 50 percent ownership are included in the financial statement package. Companies which are not consolidated are shown on the consolidated balance sheet as "investments" and any income therefrom is included under "equity in net earnings of partly-owned businesses" on the consolidated statement of earnings.

Terminology can be troublesome when one is learning a new subject. Observe that Labatt's calls the *income statement* (exhibit 2-4) a "consolidated statement of earnings"; both terms are used in practice. However, Labatt's unfortunately uses the category "income" (which is an old term, in less common use) whereas in this book we use the conventional term "revenue" or "sales" for the top section of the income statement. Also Labatt's refers to "operating costs" whereas the conventional term is "operating expenses" or "expenses". *Revenue less expenses equals income*. Overall, though, Labatt's has an excellent annual report and financial statement package and has won awards in Canada for its annual report presentation.

Corporate legislation and generally accepted accounting principles (GAAP) in Canada call for the use of comparative statements. This enables readers to form a quick impression about how the current year compares with the previous one. Many companies, including Labatt's, also provide readers of the annual report with a five or ten-year condensed financial summary elsewhere in the annual report. (Labatt's 1978 annual report amounted to 38 pages; the financial statements covered 11 pages; the balance was devoted to descriptions of the company's activities and results.) Consistent application of accounting principles and five to ten-year summaries help potential investors and creditors to establish informed judgments about a company.

Labatt's financial statement package consists of five related parts: the

EXHIBIT 2-7

Consolidated Statement of Earnings

For the Year Ended April 30, 1978
(with comparative amounts for the year ended April 30, 1977)

	1978	1977
Income		
Gross sales	$997,263,000	$922,194,000
Less excise and sale taxes	158,240,000	151,898,000
	839,023,000	770,296,000
Operating costs		
Cost of products sold	529,408,000	500,872,000
Selling and administrative expenses	229,732,000	195,299,000
Depreciation	17,471,000	16,340,000
Interest – long term	12,644,000	12,894,000
– short term	1,853,000	482,000
	791,110,000	725,887,000
Operating income	47,913,000	44,409,000
Investment and sundry income	4,267,000	2,408,000
Income before taxes	52,180,000	46,817,000
Income taxes – current	13,319,000	13,287,000
– deferred	6,410,000	7,213,000
	19,729,000	20,500,000
Earnings before the following	32,451,000	26,317,000
Equity in net earnings of partly-owned businesses	1,534,000	1,850,000
Minority interest	(90,000)	(102,000)
	1,444,000	1,748,000
Net earnings	$ 33,895,000	$ 28,065,000
Earnings per common share	$2.89	$2.45
Fully diluted earnings per common share	$2.53	$2.12

See accompanying notes

Consolidated Balance Sheet

April 30, 1978
(with comparative amounts as at April 30, 1977)

ASSETS

	1978	1977
Current		
Cash	$ 2,245,000	$ 1,743,000
Marketable securities at cost (which approximates market value)	8,998,000	8,693,000
Accounts receivable	73,271,000	69,320,000
Inventories	116,672,000	91,661,000
Prepaid expenses	15,701,000	13,086,000
	216,887,000	184,503,000
Investments and other assets		
Investment in partly-owned businesses	30,434,000	25,425,000
Investment in other companies	3,477,000	3,895,000
Mortgages, loans and advances	3,413,000	4,130,000
Due from trustees and employees under share purchase and option plans	434,000	586,000
	37,758,000	34,036,000
Fixed at cost		
Land	12,192,000	10,899,000
Buildings and equipment	352,304,000	322,709,000
	364,496,000	333,608,000
Less accumulated depreciation	163,162,000	150,294,000
	201,334,000	183,314,000
Unamortized debt financing expense	2,041,000	2,178,000
Goodwill, store licences and trademarks	60,977,000	59,110,000
	$518,997,000	$463,141,000

See accompanying notes

LIABILITIES	1978	1977
Current		
Bank advances and short term notes	$ 33,053,000	$ 9,565,000
Accounts payable	70,077,000	61,854,000
Taxes payable	11,536,000	12,696,000
Dividends payable	335,000	244,000
Long term debt due within one year	2,834,000	1,160,000
	117,835,000	85,519,000
Deferred income taxes	42,271,000	39,653,000
Long term debt	142,146,000	145,985,000
Minority interest in subsidiary companies	1,174,000	1,175,000
SHAREHOLDERS' EQUITY		
Share capital		
Authorized		
4,000,000 preferred shares		
Class A convertible common shares of no par value in unlimited amount		
Class B convertible common shares of no par value in unlimited amount		
Issued and outstanding		
605,080 Series A preferred shares (828,173 – 1977)	10,892,000	14,907,000
11,111,354 Class A common shares (10,820,717 – 1977)	63,412,000	58,741,000
471,255 Class B common shares (499,448 – 1977)		
	74,304,000	73,648,000
Retained earnings	141,267,000	121,161,000
	215,571,000	194,809,000
	$588,997,000	$463,141,000

On behalf of the Board

P N T Widdrington, Director

J H Moore, Director

Consolidated Statement of Changes in Financial Position

For the Year Ended April 30, 1978
(with comparative amounts for the year ended April 30, 1977)

	1978	1977
Sources of working capital		
From operations		
Net earnings	$33,095,000	$28,065,000
Net charges to earnings which do not reduce working capital	23,618,000	22,795,000
	56,513,000	50,860,000
Sale of properties and other assets	4,044,000	1,044,000
Reduction in mortgages, loans and advances	2,322,000	2,341,000
Proceeds on sale of partly-owned businesses	592,000	
Shares issued under share purchase and option plans	808,000	801,000
Reduction in investment in other companies	418,000	
	64,997,000	55,046,000
Uses of working capital		
Dividends – preferred	695,000	1,147,000
– common	13,694,000	12,237,000
Land, buildings and equipment	36,506,000	22,926,000
Investment in partly-owned businesses	5,821,000	8,175,000
Acquisition of Casabello Wines Ltd (net of working capital deficit $601,000)	3,726,000	
Reduction in long term debt	3,839,000	965,000
Increase in mortgages, loans and advances	1,685,000	682,000
Acquisition of additional shares of subsidiary companies		461,000
Goodwill, store licences and trademarks	865,000	319,000
Other	178,000	142,000
	64,929,000	47,054,000
Increase in working capital	68,000	7,992,000
Working capital, beginning of year	93,984,000	90,992,000
Working capital, end of year	$99,052,000	$98,984,000

See accompanying notes

Consolidated Statement of Retained Earnings

For the Year Ended April 30, 1978
(with comparative amounts for the year ended April 30, 1977)

	1978	1977
Balance, beginning of year	$121,161,000	$106,480,000
Net earnings	33,895,000	28,065,000
	155,056,000	134,545,000
Dividends		
– preferred ($1.00 per share 1978 and 1977)	695,000	1,147,000
– common ($1.14 per share 1978, $1.09 per share 1977)	13,094,000	12,237,000
	13,789,000	13,384,000
Balance, end of year	$141,267,000	$121,161,000

See accompanying notes

Notes to the Consolidated Financial Statements

April 30, 1978

1. ACCOUNTING POLICIES

The company follows generally accepted accounting principles, the most significant of which are as follows:

Principles of consolidation

The consolidated financial statements include the accounts of all subsidiary companies. The results of operations of subsidiaries acquired or sold during the year are included from or to their respective dates of acquisition or sale.

Foreign currency translation

Foreign currency assets and liabilities are translated into Canadian dollars on the following basis:

Monetary current assets and current liabilities	– at rates of exchange in effect at the balance sheet date
Inventories, prepaid expenses, fixed and other long term assets, long term debt and depreciation provisions	– at historical rates of exchange
Income and operating costs and expenses	– at average exchange rates prevailing during the year

Gains and losses arising on the translation of foreign currencies are included in earnings.

Long term debt denominated in foreign currency, including the company's share of long term debt of partly-owned businesses, translated at historical rates of exchange amounted to $21,535,000, but if translated at the rates of exchange in effect at the balance sheet date would have amounted to $23,747,000.

Earnings per common share

Earnings per common share have been calculated using the weighted monthly average number of shares outstanding during the year.

Earnings per common share on a fully diluted basis have been calculated on the assumption that all the preferred shares and all the convertible subordinated debentures outstanding at the end of the year had been converted to common shares at the beginning of the year and that all common share options outstanding had been exercised at the beginning of the year.

Inventories

Inventories, other than containers, are valued at the lower of cost, determined on a FIFO basis, and net realizable value. Containers are valued at redemption price or at estimated value not exceeding replacement cost. Inventory values are as follows:

	1978	1977
Finished and in process	$ 72,741,000	$56,276,000
Materials and supplies	31,787,000	23,445,000
Containers	12,144,000	11,940,000
	$116,672,000	$91,661,000

Investment in partly-owned businesses

Partly-owned businesses are companies and partnerships for which the equity method of accounting is appropriate. Under this method, the company's share of earnings of partly-owned businesses, net of applicable income taxes, is included in consolidated net earnings. The investments are carried in the consolidated balance sheet at cost plus the company's share of undistributed earnings since acquisition.

Investment in other companies

Investments in other companies are carried at cost and income is recognized when dividends are received. These investments include partly-owned businesses where income remittance uncertainties exist.

Fixed assets

Buildings, machinery and equipment are usually recorded at cost. Normal maintenance and repair expenditures are expensed as incurred. Gains or losses arising on the disposal of individual assets are recognized in income in the year of disposal.

Depreciation

Depreciation generally is provided on a straight line basis over the estimated useful lives of assets at annual rates of 2½% for buildings and 10% for equipment. Where appropriate, maximum capital cost allowance is claimed for income tax purposes and a related provision is made for deferred income taxes.

Unamortized debt financing expense

Debt financing expenses are amortized over the term of the issue to which they relate.

Goodwill, store licences and trademarks

Goodwill, store licences and trademarks acquired prior to May 1, 1974 are being carried at the amounts at cost without amortization.

Goodwill and other intangible assets acquired after April 30, 1974 are being amortized by charges to earnings over periods not exceeding forty years (1978 - $321,000; 1977 - $296,000). The excess of the purchase price over the net book value of assets acquired after April 30, 1974 is allocated first to land, buildings and equipment and other identifiable net assets with any remainder being allocated to goodwill. Depreciation has been charged on amounts allocated to depreciable assets.

The amount of goodwill, store licences and trademarks (of which $7,256,000 acquired after April 30, 1974 is subject to amortization) consists of:

	1978	1977
Store licences and trademarks	$ 2,937,000	$ 2,937,000
Purchased goodwill	8,248,000	8,049,000
Excess of purchase price of shares of certain subsidiary companies over net book value of assets acquired	30,649,000	28,660,000
	41,834,000	39,646,000
Less accumulated amortization	857,000	536,000
	$40,977,000	$39,110,000

Income taxes

In accordance with generally accepted accounting principles the company follows the deferral method of tax allocation. Under this method the provision for income taxes is determined from the earnings reported in the statement of earnings rather than from the company's income for tax purposes. Deferred income taxes on the balance sheet result principally from depreciation allowable for tax purposes being in excess of that included in costs and expenses. In future years, when the amounts allowable for tax purposes will be less than those reflected in the statement of earnings, the applicable income taxes will be paid and the deferred tax balance reduced accordingly.

Under this method future income tax recoveries relating to losses are provided for only where it is virtually certain, as the loss year, that earnings in future years will be sufficient to make such recoveries possible.

The 3 per cent investment tax credit enacted by the Federal government in December, 1977 but effective from April 1, 1977, resulted in a reduction in current income taxes in the amount of $1,200,000.

2. PARTLY-OWNED BUSINESSES

These investments include McGavin Foods Limited (formerly McGavin ToastMaster Bakeries Limited), Canada Malting Co., Limited, Toronto Blue Jays Baseball Club, Cervejarias Reunidas Skol-Caracu S/A, Brazil, Castelli Primo Limited, Trinidad and Nana Managing, United States of America.

	1978	1977
Investment at cost	$23,705,000	$18,680,000
Accumulated equity in undistributed earnings since acquisition	6,729,000	6,745,000
	$30,434,000	$25,425,000

During the year the company disposed of its investment in H.E. Saunders and Sons Limited, entered into a partnership with Nana Regional Corporation in Alaska and increased its investment in Cervejarias Reunidas Skol-Caracu S/A.

3. LONG TERM DEBT

Particulars of debentures payable and other long term debt are as follows:

	1978	1977
Sinking fund debentures		
6% Series B to mature January 2, 1979	$ 186,000	$ 445,000
6½% Series C to mature May 15, 1981	1,048,000	1,283,000
6½% Series D to mature June 15, 1987	4,071,000	4,253,000
6½% Series E to mature October 1, 1989	3,366,000	3,366,000
7⅛% Series F to mature April 15, 1992	4,850,000	5,075,000
9½% Series G to mature September 1, 1990	26,875,000	27,825,000
8¼% Series H to mature March 1, 1993	29,325,000	30,000,000
9% Series I to mature March 15, 1994	30,000,000	30,000,000
9½% Convertible Subordinated Debentures to mature June 1, 1995	32,938,000	33,000,000
Term bank loan repayable May 1, 1978 to 1982	7,000,000	7,000,000
	139,659,000	142,247,000
Advances, mortgages and other long term liabilities	5,321,000	4,898,000
	144,980,000	147,145,000
Less portion due within one year included in current liabilities	2,834,000	1,160,000
	$142,146,000	$145,985,000

The 9½% Convertible Subordinated Debentures are convertible on or before June 1, 1985 at the holder's option into Class A common shares of the company at a conversion price of $18.25 per share.

Maturities and sinking fund requirements for the years 1979 through 1983 are $2,834,000, $5,902,000, $6,786,000, $7,040,000 and $6,158,000 respectively.

At April 30, 1978 the company had satisfied all of the covenants under the trust deed relating to the debentures.

4. SHARE CAPITAL

The company has elected for continuation under the Canada Business Corporations Act. Through the enactment of a by-law the company is a constrained share corporation whereby the total number of voting shares outstanding to be held by non-residents is restricted to 20% and the number to be held by any single non-resident is restricted to 10%.

Common Shares

Under the provisions of the Canada Business Corporations Act and the company's by-laws, the company's authorized common share capital is unlimited as to the number of shares which may be issued.

The two classes of common shares are interchangeable one to another and are subject to the same rights and conditions except in respect of dividends. Dividends paid on the Class A and Class B shares are identical in amount but result in a different tax treatment when received by shareholders. After December 31, 1978, dividends received by shareholders on the Class B shares will not be entitled to this different tax treatment.

Preferred Shares

Of the 4,000,000 authorized preferred shares 605,080 shares are outstanding as Series A preferred shares. The balance of 3,394,920 shares are available for future issue with conditions and preferences as determined by the Board of Directors. Series A preferred shares have a par value of $18 each, are redeemable at par, are non-voting (unless four quarterly dividends are in arrears) and are entitled to cumulative annual dividends of $1 per share.

Each Series A preferred share is convertible to one Class A common share of John Labatt at any time up to the close of business on February 15, 1980 or to the close of business on the date immediately prior to the date fixed for redemption, whichever is earlier. At April 30, 1978 none of these shares had been called for redemption. Of the 3,063,590 Series A preferred shares which were originally issued, there have been 2,458,510 converted to common shares.

Share Purchase and Option Plans

From time to time the company has established various share purchase and option plans. The following schedule sets out details of amounts due from trustees and employees under these plans:

	1978	1977
Due from trustees under the issued share option plan (1978 - nil shares, 1977 - 5,150 shares)		$ 75,000
Due from employees under share purchase plans (1978 - 34,067 shares, 1977 - 36,367 shares)		
Officers	$ 96,000	124,000
Other employees	338,000	387,000
	$434,000	$586,000

Issued Share Option Plan

During 1967 the company established an issued share option plan. The trustees of this plan acquired 33,500 common shares for future sale to employees and granted options on these shares exercisable at $14.50 per share up to September, 1977. Options covering 32,950 shares have been exercised, fully paid for and the shares transferred to employees. The trustees have sold the issued shares relating to unexercised options and returned the proceeds to the company.

Share Purchase Plans

In certain prior years the company established various employee share purchase plans. Under these plans, the individuals are entitled to purchase the shares and pay for them over periods of up to 15 years.

Shares Available for Share Purchase and Option Plans

During 1975 the company enacted a by-law which made available 750,000 unissued Class A common shares for allotment to employees under share purchase or option plans. At April 30, 1978 these shares were allocated as follows:

Under option	207,850
Reserved for employee share purchase plan maturing in June, 1979	36,912
Issued	33,962
Available for future issuance or option to employees	451,276
Total	750,000

Under the provisions of the by-law the Board of Directors is not restricted with respect to any allotment of these shares.

Details of shares under option to employees (207,850 allotted under this by-law and 7,875 allotted under a previous by-law), as of April 30, 1978 are as follows:

Plan	Number of shares	Price per share	Expiry Date
1974 Share option	7,875	$12.85	December 1984
1975 Share option	80,350	19.00	December 1979
1975 Share option	29,750	19.00	June 1981
1975 Share option	97,750	19.00	December 1983
	215,725		

Of the 215,725 shares under option there are 95,750 under option to officers of the company.

Shares Converted and Issued During the Year

During 1978 changes in the company's issued shares were as follows

	Series A Preferred Shares	Class A and Class B Common Shares
Issued and outstanding at April 30, 1977	828,173	11,321,158
Conversions	(223,093)	223,093
Issued under employee share purchase and option plans for a cash consideration of $594,000		34,962
Issued as a result of conversions of the 9½% convertible subordinated debenture at $18.25 per share		3,396
Issued and outstanding at April 30, 1978	605,080	11,582,609

Principal Shareholder

To the knowledge of the directors and officers of the company, Brascan Limited is the only shareholder who beneficially owns, directly or indirectly through a wholly-owned subsidiary, shares carrying more than 10% of the votes attached to shares of the company Brascan Limited beneficially owns, controls or directs, 2,960,100 Class A shares of the company representing approximately 25.56% of the aggregate outstanding common shares

5. LEASES, COMMITMENTS AND GUARANTEES

Leases

The company has entered into or guaranteed long term leases substantially all of which will be discharged within 16 years. Fixed rental expense for 1978 was $4,360,000. Approximate future annual fixed rental payments are as follows

1979	$ 4,571,000
1980	4,174,000
1981	3,664,000
1982	3,102,000
1983	2,426,000
	$17,937,000

Fixed rental payments for subsequent years and guarantees amount to $16,716,000

Certain store leases require payments related to sales and/or additional charges for increased costs. The amount of such additional rental expense for 1978, not included in the amount above, was approximately $975,000

In addition to the above, under the terms of vehicle leases, rentals for the next 3 years will amount to approximately $6,000,000 per annum

Commitments

During 1979 the company plans capital expenditures of approximately $38,384,000. Of this amount $5,090,000 was represented by commitments at April 30, 1978

During the year the company and Redpath Industries Limited announced their intention to investigate the economic feasibility of constructing a $60 million plant in Southwestern Ontario to produce high fructose syrup from corn for Canada's food industry. This project is still in the study stage and has not been included in the above planned capital expenditures. If the partners decide to proceed with this project, the company's share of the construction costs will be an additional $30,000,000 over the next two years

Also the company has initiated a feasibility study of a world scale wheat starch and gluten facility to be constructed in Aiken County, South Carolina. If the project proceeds to construction, the company will incur $23,000,000 for additional capital expenditures over the next two years

The company has a commitment to provide financing, if required, to complete the purchase of its interest in Cervejarias Reunidas Skol-Caracu S/A in the years 1979 and 1980 of approximately $1,383,000 and $1,356,000 respectively

Guarantees

The company has guaranteed various loans and payments amounting to approximately $4,700,000 in aggregate

6. PENSIONS

During the year the company made revisions to certain of its pension plans providing for increased benefits. As a result, based on the most recent actuarial valuations, the company's unfunded obligations at December 31, 1977 were $10,686,000

Past service costs relating to improved benefits are funded and charged to operations over periods not exceeding 15 years. Current service costs are funded and charged to operations as they accrue

7. ANTI-INFLATION LEGISLATION

As of May 1, 1978, the company and its Canadian subsidiaries are no longer subject to the federal government's anti-inflation legislation relating to the control of prices and profit margins. However, the company and its Canadian subsidiaries will continue to remain subject to the restrictions relative to dividends until October 13, 1978 and to the restrictions controlling levels of employee compensation to varying dates up to December 31, 1978

8. ACQUISITIONS AND DISPOSITIONS

Effective September 1, 1977, the company acquired 100% of the outstanding shares of Casabello Wines Ltd. Details of net assets acquired, accounted for under the purchase method, are as follows

Assets acquired at book value	$4,235,000
Less liabilities assumed	3,403,000
Net tangible assets acquired	832,000
Allocated to fixed assets	304,000
Allocated to goodwill (including contingent consideration of $317,000)	1,989,000
Purchase Price	$3,125,000

Under the terms of the Option and Voting Trust Agreement entered into between the company and the shareholders of Casabello in 1972 the purchase price of the shares has been calculated annually by the auditors of Casabello and has been sent by Casabello to its shareholders who have had an annual right to require the company to purchase their shares at the calculated price. During 1977 a difference arose between the company's representative and the shareholders on the board of Casabello as to the proper method of calculating the purchase price. While this difference could not be resolved the parties did agree that if the purchase price was calculated using the same method as had been used in each of the previous four years the purchase price would be $2,808,000 but that if the different method was used, as advocated by the Casabello shareholders, the purchase price would be increased by $317,000. In order to avoid delay the company deposited the additional amount with the depositary under the Option and Voting Trust Agreement and took delivery of the shares. The dispute was referred to arbitration, the arbitration hearing has been held and the decision is expected during the summer. If the company is successful, the additional amount of $317,000 will be returned to it

During the year the company disposed of its soft-drink operation in Newfoundland and also disposed of its dry livestock feed operation in Quebec and in each case the total cash consideration approximated the net book value of the assets sold

9. REMUNERATION OF DIRECTORS AND OFFICERS

During 1978 the total remuneration paid to thirteen of the company's eighteen directors, as directors, was $133,500 and to four of these directors as directors of subsidiary companies was $13,100

The company's twenty officers received remuneration totalling $1,610,000. The five officers who served as directors received no additional remuneration as directors

10. CLASSES OF BUSINESS

The directors have determined at a meeting of directors and have recorded in the minutes thereof the classes of business in accordance with Section 47 of the Canada Business Corporations Regulations, based upon the functional and managerial organization of the company. The following is a summary of the gross sales, contribution from, and assets employed in the classes

	1978		1977	
(in thousands of dollars)	Gross Sales	Percentage	Gross Sales	Percentage
Brewing	$512,351	51.4%	$479,367	52.0%
Consumer Products	256,739	25.7%	213,077	23.1%
Agri Products	228,173	22.9%	229,750	24.9%
	$997,263	100.0%	$922,194	100.0%
	Contribution	Assets Employed	Contribution	Assets Employed
Brewing	$46,946	$189,092	$44,028	$170,394
Consumer Products	7,749	136,423	5,146	112,425
Agri Products	11,984	78,266	11,019	78,943
	66,679	$403,781	60,193	$361,762
Interest	14,499		13,376	
Income before taxes	$52,180		$46,817	

11. THE COMPANIES ACT (BRITISH COLUMBIA)

The Companies Act (British Columbia) requires consolidated financial statements to include the names of every subsidiary company but permits the circulation within the province of statements which do not so comply

These consolidated financial statements include the accounts of all subsidiary companies. A list of all of the subsidiaries of the company is available for inspection at the company's registered office in British Columbia

12. SUBSEQUENT EVENTS

The company has agreed in principle to acquire all of the operating assets of Bear Mountain Winery of Bakersfield, California. Consideration for the winery's assets will be the assumption of substantially all of its liabilities. Bear Mountain Winery is a grower co-operative and the transaction is subject to the approval of the grower – members and appropriate regulatory authorities

The company has also agreed in principle to acquire for cash all of the outstanding shares of Beurrerie Laiterniere / Laiterie Dallaire, a dairy and an industrial milk processor in north-western Quebec, effective May 31, 1978

four financial statements mentioned earlier in the chapter (consolidated statement of earnings; consolidated balance sheet; consolidated statement of changes in financial position; and consolidated statement of retained earnings) plus 12 "Notes to the Consolidated Financial Statements." The auditors' report (reproduced in Exhibit 1-1, page 17) accompanies the financial statement package and reports whether or not the statements present fairly in accordance with generally accepted accounting principles.

Measurement and disclosure

The use of notes to financial statements has increased dramatically in the past 15 years in Canada. For many decades accountants were concerned with measurement and the figures on either or both of the income statement and balance sheet. In the late 1800s and portions of the 1920s and 1930s, the balance sheet was important because potential creditors wanted to know what and how much security existed for any loans which they may have wished to make.

In 1917 the first Income Tax Act was introduced in Canada; this obviously put greater pressure on accountants to measure a concept called income. Later, investors used the income statement to assess success. In short, more and more users with somewhat different needs began to look to accounting statements for assistance.

In the 1900s (especially after 1950), research into the efficiency of share-trading on stock markets brought forth considerable evidence about the ability of investors to evaluate financial statements. For example, prior to this, some people believed that changes in net income would cause a *direct* effect on the company's share price as soon as the financial statements were made available to the public. However, the evidence for companies which were widely traded on large stock exchanges indicated that people could "see through" accounting figures. That is, the figures were assessed for reliability and credibility before investors chose to reflect effects in share prices. Sometimes investors believed the accounting figures; sometimes they did not. *If* new information was provided in the financial statements it was quickly reflected in share prices by investors who bought and sold.

Evidence also showed that potential creditors and investors wanted *more* financial information about a company. Since much of the desired information could not be captured by the conventional balance sheet and income statement (which were primarily concerned with *measurement*) the logical step became one of providing notes which give greater *disclosure*. The importance of *measurement* and *disclosure*, and the relative significance of each in different situations is discussed from time to time throughout the book. Together with market efficiency research, the implications of mea-